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SUBJECT: CANADIAN INVESTORS WARY OF HUMALA

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Classified By: Ambassador J. Curtis Struble for reasons 1.4 (b) and (d)
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11. (C) Summary. During a March 31 meeting, Canadian Ambassador Genevieve Des Rivieres provided Ambassador Struble with a readout of the nearly two hour meeting she hosted the day before between Ollanta Humala and Canadian investors. Ambassador Des Rivieres shared two impressions: first, that Humala had a shallow understanding of investment and trade issues; and second, that Humala always spoke of doing things within the law, even as he emphasized his determination to change current legislation. Ambassador Des Rivieres stated that nothing Humala said led her to believe he would govern in an authoritarian manner. The Canadian Trade Commissioner, who attended the same meeting, had a much bleaker outlook. He informed us that Canadian investors remained worried about a Humala government, as both Humala and his economic advisor lacked specific knowledge about the oil, gas and mining industries -- Peru's most important economic sectors. End Summary.

Canadian Investors Meet with Humala

12. (C) The Canadian Embassy hosted a meeting between ultra-nationalist presidential candidate Ollanta Humala and several Canadian investors on March 30. Economic Advisor Felix Jimenez accompanied Humala and proceeded to answer most of the economic questions. Canadian Ambassador Genevieve Des Rivieres noted that Jimenez's responses highlighted that Humala lacked a clear understanding of economic and investment issues. For example, Humala was flummoxed by one question from an operator who has a 30 year Build-Operate-Transfer (BOT) contract; the candidate had never heard of a BOT arrangement and after a lengthy explanation said he thought they would be alright with him. Des Rivieres also pointed out that Humala always spoke of doing things within the law, even as he emphasized his determination to change current legislation.

13. (C) Ambassador Des Rivieres informed the Ambassador that, due to the meeting, she was less anxious about a Humala government. She highlighted Humala's pledge to follow the rule of law when making changes to the Constitution and

existing contracts. Ambassador Des Rivieres still has reservations about Humala, however, as the majority of Canadian investment in Peru is in the mining sector. (Note: Canada is one of the largest investors in Peru, with investment in the mining sector totaling an estimated \$637.2 million in 2005. End Note.) Humala indicated several times in the meeting that he would revise mining contracts.

Trade Commissioner Offers Different Viewpoint

14. (C) Ed Jager, Senior Trade Commissioner at the Canadian Embassy, met with Econoffs to discuss his views on the Humala meeting. As noted in his report below, Jager emphasized that while Humala said the right things to the investors, including how he would respect the rule of law as President, the meeting did little to alleviate the concerns of the Canadian investors. During the meeting, Jager noted how Humala's answers to specific investor's questions were vague, offering little detail. According to Jager, Humala did most of the talking, turning to Jimenez occasionally for a technical answer. Jager observed that Jimenez did not come across as knowledgeable about the details of the oil and gas or mining industry royalty or tax arrangements, which amplified concerns among some Canadian investors.

Canadian Ambassador's Report

15. (C) The following is Canadian Embassy report on the Humala meeting, provided by Ambassador Des Rivieres. (Note: It is not clear that the Ambassador had prior authorization to share this memorandum, as well as the Trade Commissioner's report; addressees should act on the assumption that they were provided extra officially. End Note.)

Begin Text:

16. (C) Nationalization: Humala was quick to point out that many had misconstrued his use of the word "nationalization." People should not associate his ideas with the ideas of 40 years ago (presumably referring to the leftist General Velasco, whose government expropriated and nationalized much of the financial, industrial and resource sectors, devastating the Peruvian economy in the process.) Humala believes that the government should have a far greater role in what he considers strategic sectors, but explicitly denies the use of expropriation and "estatizacion" (nationalizing) to achieve that role. Instead, he seeks to use the tools of government investment and tighter regulation to increase the role of the state in the economy. He would rewrite the Constitution (through a Constituent Assembly) to drop the ban on state participation in economic activity. He clearly stated he does believe and recognize the rights and contribution of private/foreign investment in Peru in terms of job creation and infrastructure development. An increased state role is necessary to ensure increased Peruvian participation in the economy. However, Humala reiterated his belief in the right to private property.

17. (C) Strategic Activities: On Humala's list of strategic activities are included the oil and gas sector (especially the Camisea project), other energy industries (including electricity), ports and airports. However, mining per se was not a strategic activity. Moreover, he indicated that he would respect existing concessions. He suggested that international investors were important to Peru, bring not only needed capital but also technology and know how. He would like as well to diversify the base of the economy by promoting, for example, the agrifood industry. In large part, his view of strategic industries appears to be focused on the part they play in providing goods and services to the man in the street. In the vein, he wants the state to protect prices so the poor can have access to the necessities they need. LAN Peru (owned by LAN Chile) was cited as an example of a monopoly which needed to be challenged by a

national carrier to reduce prices and increase choices for consumers.

18. (C) Access to Finance: Humala argued that the Peruvian market is small and fractured, making it difficult for Peruvian companies to compete with international companies. Therefore it was particularly important that reliable and easy access to finance be available. In his view, there are few banks in Peru and not enough competition. A Humala government would seek to increase the size of the market and access to finance for all Peruvian entrepreneurs, especially for those in micro and small enterprises. One way to increase the amount of local investment would be to ensure that the amount that private pension funds are allowed to invest abroad would be maintained at 10 percent, or even reduced. Another approach would be to "de-dollarize" the internal economy so that small and medium enterprises would be able to borrow or repay loans in the national currency.

19. (C) Paying for Increased Government Participation: When asked how he would pay for a significant government investment in strategic activities, Humala outlined a number of ways. By reforming the tax system so as to levy more direct taxes and less indirect taxes, more revenue would be collected. Similarly, a strong effort would be mounted to reduce tax evasion and review all tax exonerations. A Humala government would also seek to convert the national debt held by foreigners into domestic debt, thus reducing the costs to the government of exchange fluctuations. As the national debt came up, it would be renegotiated, reducing interest costs. On the other hand, he wishes to see longer repayment terms for Peruvian debt, to allow more fiscal room for short-term projects. Humala believes these steps will fund his plans to significantly increase the government presence in strategic activities. In any case, however, a Humala government will recognize the necessity to limit the fiscal deficit to 1.5 percent of GDP. For that reason, Humala would also be open to other forms of participation, including PPPs and concessions. Humala estimates infrastructure costs in the five years of his government would average \$3.9 billion per year, of which he expects between \$1.5 - \$1.7 billion to come from the Peruvian government.

10. (C) Working with Foreign Companies: Humala declared that he was perfectly willing to work with foreign investors. He added, he would only do so in an open and transparent manner, always within the law. Alluding to the example of discussions between Fujimori's fixer Montesinos and an American mining company representative, Humala stated that he would not deal with foreign investors in a like manner. Furthermore, he stated that in a situation where his government had to choose between two investors, one Peruvian and one foreign, all other things being equal, he would always choose the Peruvian. He envisions a type of affirmative action program which allows national industry to be more active in the economy. He claims that in many cases, national companies have been discriminated against in international bids because criteria included levels of capital which national industry did not have. However, he repeated his belief that Peru needs foreign private sector investments, particularly for infrastructure projects where large amounts, modern technology and "savoir-faire" are involved. He appears to be comfortable with the PPP approach.

11. (C) Stability Agreements: It was pointed out to Humala that in the mining industry in particular, long term investments of 20-30 years were the norm. For that reason, legal stability, especially tax stability, was essential. Humala and his advisor responded that in 20 or 30 years of an investment, conditions change. They argued that since many of the current legal stability agreements in force in Peru were signed in the mid-1990s under Fujimori, they need to be reviewed and, if necessary, revised to reflect current conditions (both internal and external to Peru). Such revisions would not be unilateral, as a Humala government will respect the law. However, it was clear that Humala

believes that legal stability agreements should not exempt mining companies from paying royalties. He was insistent that all companies should pay royalties and taxes. (In another context, Humala specifically and explicitly stated that those mining companies with stability agreements exempting them from paying royalties would have their contracts reviewed.)

¶12. (C) Mining Canon: The Canon Minero is the share of mining taxes and royalties that is returned to the regions, districts and municipalities surrounding the mines from which that revenue is collected. Much of those funds remain in the Treasury for lack of capacity to use them. Humala agrees that this is an intolerable situation, and will work with the various levels of government involved, including through capacity building, to see that these funds are appropriately spent on priorities of education, health and infrastructure.

¶13. (C) Constitutional Change: Humala believes that the current Peruvian Constitution, "criminally" and "delinquently" written and approved in the Fujimori years, is a neo-liberal construct that doesn't provide for the development of the country. He has stated that he would call for a constituent assembly to rewrite the Constitution. However, to do so, he would need the support of Congress, and Humala is unlikely to achieve sufficient support in Congress to do so. He indicated that he would abide by the law, but that Constitutional change was an absolute imperative for him. When asked whether he would respect the principle of not applying Constitutional or legislative changes retroactively, he responded only indirectly, repeating his pledge to stay within the law, and not to expropriate private property.

¶14. (C) Narco-trafficking: Drug trafficking is a cancer. A Humala government will take all necessary steps to combat this cancer, including interdiction flights, fighting the cartels and controlling the import of inputs. However, it would be necessary to consider the negative effects of fighting drug trafficking on the innocent coca grower. He specifically rejected eradication campaigns. Profitable alternatives would have to be found for the farmers, as well as legal markets for coca leaves, process coca and by-products. International cooperation was going to be important in this regard.

¶15. (C) Corruption: A Humala government would investigate, prosecute, and jail all those guilty of corruption. This was a high priority for Humala. He agreed that a desire within the judicial system to eliminate corruption as essential to success. He had little to offer on how to create that desire, but would intervene if necessary.

End Text.

Canadian Trade
Commissioner's Views

¶16. (C) The following is the Canadian Economic Counselor's report on the Humala meeting with investors. This report indicates that Canadian investors continue to be wary of a Humala government, despite pledges to follow the rule of law, and believe that Humala's signals vary by audience. (Note: This memorandum should also be protected. End Note.)

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¶17. (C) Summary: Ollanta Humala, the retired Peruvian army "comandante" (Lieutenant Colonel) and populist candidate for President currently ahead in the polls, met yesterday with a group of Canadian investors at the invitation of the Ambassador. Responding to questions for ninety minutes, Humala set forth his vision of a national government that would participate more significantly in "strategic activities." He was quick to deny that this participation would entail expropriation or state-run enterprise, stating instead that his government would use the tools of investment

and tighter regulation to ensure that the benefits of economic activity in Peru flowed to those who had been excluded in the past. His comments did not instill much confidence in the investors present. Uncertainty and unease were the order of the day, and will continue to be so should Humala win.

¶18. (C) Report: On April 9, Peruvians will vote for a new Congress and a new President. If none of the presidential candidates receive more than 50 percent, as is expected, the two top vote-getters will face each other in a run-off on May ¶7.

--Over the last several months, populist candidate Ollanta Humala has been gaining in the polls, achieving the top position in recent weeks. Lourdes Flores, his right of center opponent, has fallen to second place, while former President and left of center candidate Alan Garcia holds a substantial third. Given the fluid nature of Peruvian politics, all three must be considered capable of getting to the second round.

--Given Humala's rise in the opinion polls and Canadian investors' concerns, the Ambassador invited him to meet with a group of Canadian investors at the Official Residence, to allow them to ask him questions about the issues concerning them. He agreed.

--In the nearly two hours that Humala sat with the Canadian investors (representing mining, banking, information and computer technology, engineering and energy sectors), he and his economic advisor, Felix Jimenez answered a wide range of questions.

--Canadian investors left the meeting little changed in their view of Humala. Most came to the meeting concerned about Humala's public pronouncements relating to the revision of legal stability agreements, the need to increase taxes and royalties paid by mining companies, and his desire to enlarge the role of the state in "strategic activities." Their concerns were not mollified by his statements at this meeting.

--Most attendees felt that Humala's statements were often vague and lacking in sufficient detail. They supported those critics who suggest that Humala's platform is largely improvised and fails to comprehend the reality of international business. They were not convinced by his assurances that he would respect existing contracts and concessions, and not unilaterally alter the rules of the game in mid-match.

¶19. (C) Comment: The prospect of a Humala government is generating much uncertainty in the investment community. Like a Lima taxi driver, whose next move is entirely unpredictable regardless of where he is presently on the road, the only reasonable tactic appears to hang back a bit and stay out of his way. The signals Humala gives vary greatly depending on his audience. To the low income crowds who will generate the majority of votes, he is quick to denounce foreign control of Peru's resources. To the investment crowd his tone is considerably muted, with many assurances that his government would respect the rule of law. Would he talk to the left but govern to the right, as other Latin American leaders are accused of doing? Of course, he will have to win first and that is not yet guaranteed. If he does, uncertainty and unease will be the prevailing mood among investors for several years to come.

End text.
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